



OFFICE OF  
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY  
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This responds to your letter to me regarding section 457 of the Internal Revenue Code (the "Code"). You submitted questions regarding investment options in sections 403(b) and 457 plans, the catch-up provisions for both types of plans, the required look-back period and the new rollover provisions. We cannot definitively discuss your situation without additional information, including a copy of your employer's sections 403(b) and 457 plans. However, with this letter, we are providing general information and materials about sections 403(b) and 457 that may be helpful.

### **Investment Options**

By statutory provisions under sections 403(b)(1) and (7), the only types of investments that may be made in a section 403(b) account are annuity contracts provided through an insurance company or custodial accounts invested in mutual funds.

Concerning eligible section 457 plans, § 1.457-1(b)(1) of the Income Tax Regulations states that "the participant is permitted to choose among various investment modes under the [eligible section 457] plan for the investment of such amounts whether before or after payments have commenced under the plan." Although this provision does not limit the investment options that may be offered through a section 457 plan, it does limit section 457 plan participants to the investment options offered under their employer's eligible plan. In addition, an eligible plan is not even required to provide any investment option. The investment options provided under a section 457 plan are determined by the plan sponsor. We have not heard of any section 457 plan that permits its participants to have a self-directed stock investment account; section 457 plans generally limit their investment options to savings and insurance products and mutual funds. Without reviewing your employer's section 457 plan, we cannot tell you what investment options it provides.

## Catch-up Provisions

Regarding catch-up provisions under section 403(b), a section 403(b) arrangement may include limited, complex catch-up provisions available only to certain employees. These provisions and their detailed requirements are discussed in the "Alternative Limits on Annual Additions" section on page 14 of the enclosed Publication 571, *Tax-Sheltered Annuity Plans*. However, these provisions are repealed, effective on and after January 1, 2002, under the new tax laws. Additional information regarding this and other significant changes to the tax laws will be discussed in Publication 553, *Highlights of 2001 Tax Changes*, which will be available in January 2002.

We are unable to discuss the specific catch-up rules provided under your employer's section 457(b) plan without examining the plan. However, § 1.457-2(f) concerning the section 457 catch-up provisions permits the plan to provide a limited catch-up for any, or all, of the last three calendar years ending before the year in which the participant attains normal retirement age as defined under the employer's plan. Under the catch-up provision, a participant may defer an additional amount equal to any deferral limitation not used for prior taxable years after December 31, 1978, in which the participant was eligible to participate under the section 457 plan. In other words, a participant may use these catch-up provisions to defer amounts that s/he had previously been eligible to defer in her/his section 457 plan account during his career after 1978, but that s/he had previously failed to use. Thus, if a 457 plan participant has always contributed the maximum amount that s/he was eligible to contribute to his/her section 457 plan account (or an equivalent or greater amount to his/her section 403(b) account), s/he would not be able to contribute any additional amount under the section 457 catch-up provision now or in future years. The amount that can be deferred under the catch-up provision is currently limited to the lesser of \$15,000 a year or the sum of the otherwise applicable limit for the year plus the amount by which the limit applicable in preceding years of 457 participation exceed the deferrals for that year. It should be noted that the section 457 catch-up limitation will be increased under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), beginning in 2002; for example, in 2002, a section 457 participant will be subject to a limit of the lesser of \$22,000 or the above discussed limitation.

It should also be noted that every dollar a participant contributes from 1979 through the end of 2001 to his/her account in a section 403(b) plan, a section 401(k) plan, a SEP-IRA or a SIMPLE plan (but not the state retirement plan) reduces the amount he could contribute as a catch-up contribution to his/her section 457 plan account by one dollar. However, any contribution you make after December 31, 2001 to your account in a section 403(b) plan or other non-457 plan will no longer be counted in reducing the catch-up contributions you could make for 2002 or later years to your section 457 plan account. Additional information regarding the limited catch-up provisions is provided in the enclosed copy of § 1.457-2(f) of the Income Tax Regulations.

## **Look-back Period**

In your letter, you asked how far back you and your employer would have to look up the records of your contributions to your section 403(b) account and your state retirement plan for purposes of applying the maximum exclusion allowance (MEA) under section 403(b) and the catch-up limitation under section 457(b)(3). For purposes of applying the section 403(b)(2) MEA provisions in effect through the end of 2001, you would need to get records of all your (and your employer's) contributions to your section 403(b) accounts since the first year of such contributions. In addition, if your state retirement plan is a defined contribution plan (but not if it is a defined benefit plan akin to a pension plan), you would also need the records of your contributions to that plan throughout your career for purposes of determining your MEA for 2001. However, EGTRRA repeals the MEA, effective on and after January 1, 2002. Additional information regarding the MEA and how to determine it can be found in the "Maximum Exclusion Allowance" section beginning on page 5 of the enclosed Publication 571.

For purposes of applying the section 457 catch-up provisions discussed above, in addition to the section 457 plan contribution information described above, you will need records of your contributions to your 403(b) account for every year from 1979 to and including 2001 in which you were eligible to contribute to a section 457 plan, even if you had previously made no contribution to a section 457 plan. You would need to retain this record, even after this year for purposes of determining how much catch-up contribution you could make to your section 457 plan account relating to the years between 1979 through 2001 inclusive.

## **New 50+ Catch-up Provisions**

EGTRRA also enacts a new section 414(v) of the Code that, beginning in 2002, authorizes section 403(b) annuity contracts, section 457(b) plans, section 401(k) plans and several other types of qualified retirement plans to permit individual participants age 50 or older to make limited catch up contributions to their plan accounts; for example, in 2002, each eligible participant may make up to \$2,000 of catch-up contributions. However, these plans are not required to include this catch-up provision. It should also be noted that a section 457(b) plan participant may not use both the new 50+ catch-up provision and the other section 457 catch-up provision discussed above in the same calendar year. The provisions and requirements of section 414(v) are discussed in proposed regulations § 1.414(v)-1 that the IRS has just published. To provide you with further information concerning the new section 414(v) catch-up provisions, we have enclosed a copy of these proposed regulations with this letter.

## **New Rollover Provisions**

Due to the changes enacted in EGTRRA, beginning in 2002 an employee participating in a section 403(b) annuity or custodial account or in a governmental

section 457 plan may roll over an *eligible rollover distribution* on a tax-deferred basis to another eligible retirement account including a section 401(k) plan, an individual retirement arrangement (IRA), a governmental section 457(b) plan or a section 403(b) arrangement. Beginning in 2002, an eligible rollover distribution will be any distribution from a governmental section 457(b) plan, a qualified pension plan (including a section 401(k) plan) or a section 403(b) tax-sheltered annuity that is not either 1) a minimum required distribution or 2) one of a series of substantially equal periodic payments made over the participant's life expectancy or a specified period of 10 or more years. However, it should be noted that the plan "receiving" such rollover is not legally required to accept such a rollover, with the result that the participant might have to make such rollover into his/her IRA.

The restrictions and guidelines that currently apply to rollovers from IRAs and 401(k) plans will also apply to rollovers to and from section 457(b) plans and 403(b) arrangements. For example, the rollover must be completed within 60 days and equal periodic payments, hardship distributions and minimum required distributions do not qualify as eligible rollover distributions that could be rolled over into a different eligible retirement plan. Additional information regarding the new rollover provisions and other significant changes to the tax laws will be discussed in Publication 553, *Highlights of 2001 Tax Changes*, which will be available from the IRS in January 2002.

I hope this general information letter and the enclosed materials are helpful. If you need further assistance, please contact John Tolleris (ID# 50-07323) of my staff at (202) 622-6060.

Sincerely,

ROBERT D. PATCHELL  
Acting Chief, Qualified Plan Branch #2  
Office of the Associate Chief Counsel  
(Tax Exempt and Government Entities)

Enclosures (3):

Publication 571, Tax-Sheltered Annuity Plans  
§ 1.457-2(f) of the Income Tax Regulations  
Proposed § 1.414(v)-1 of the Income Tax Regulations

CC:TEGE:EB:QP2/GENIN-153129-01/11-09-2001/jat